Valuations & Earnings

February 2021

S&P 500 Earnings Rebound

Key Observations

- As of December 31, analysts had estimated earnings would decline by 9.3% in the fourth-quarter.
- With more than half of the S&P 500 having already reported earnings, year-over-year profit growth stands at 1.7%, according to data from FactSet. That's on pace to be even better than the fourth quarter of 2019, when earnings grew 0.8%.
- In other words, corporate profits are on pace to exceed pre-pandemic highs even before additional stimulus, wider distribution of vaccines, and a more robust economic re-opening even take hold.

Update on Valuations:

While a large portion of last year's run-up can be attributed to significant stimulus/intervention (both fiscal and monetary (Federal Reserve)) as well as positive vaccine developments, many investors may not realize how positive fourth quarter earnings have been thus far. Equity valuations, particularly on the U.S. side, remain elevated to historical multiples, but the strong rebound in corporate earnings is a very notable development.

Below are several resources adding to this narrative.

The stock market's biggest driver of gains is on pace for a surprise return to positive territory for the first time since the pandemic started

By: Matthew Fox
Feb. 8, 2021, 06:06 PM
Link to Article

Corporate earnings growth, which has historically been the main driver of stock market returns, is set to return to expansion territory for the first time since the fourth quarter of 2019.

With more than half of the S&P 500 having already reported earnings, year-over-year profit growth stands at 1.7%, according to data from FactSet. That's on pace to be even better than the fourth quarter of 2019, when earnings grew 0.8%.

Corporate profits plunged in the first three quarters of 2020 amid the COVID-19 pandemic, and were expected to continue that decline in the fourth quarter. As of December 31, analysts had estimated earnings would decline by 9.3% in the fourth-quarter.

But positive earnings surprises from companies within the financial, technology, and communication services sectors helped drive better than expected earnings for the quarter. On the flipside, the industrials sector was the largest detractor to the improvement in earnings for the fourth-quarter, according to FactSet.

Of the S&P 500 companies that have already reported earnings, 81% have reported a positive EPS surprise, and 79% have reported a positive revenue surprise.

"If 81% is the final percentage, it will tie the mark for the second-highest percentage of S&P 500 companies reporting a positive EPS surprise since FactSet began tracking this metric in 2008," FactSet said in a Friday note.

For all of 2020, S&P 500 companies are reporting an earnings decline of 11.4% and a revenue decline of 1.1%. But 2021 should represent a strong return to growth for corporate earnings, according to analyst estimates.

For calendar year 2021, analysts project earnings growth of 23.4% and revenue growth of 9%, according to FactSet data.

The recent earnings data gives the S&P 500 a 12-month P/E ratio of 22.0x, which is above its 5-year and 10-year averages of 17.6x and 15.8x, respectively, according to FactSet.

Earnings say we're early cycle

By: Myles Udland, Markets Reporter
Wed, February 10, 2021, 4:52 AM
Link to Article

Fourth quarter earnings season is rolling along and results to date have been fantastic.

As Sam Ro chronicled in Monday's Morning Brief, through last week 81% of companies in the S&P 500 that had reported earnings so far beat expectations by an average of 15.2%.

At the end of 2020, we argued in this space that what had in part gotten investors enthusiastic about stocks last year was the anticipation of corporate results rebounding more quickly than feared. And indeed these results continue to confirm what the market has been out in front of for some time now.

Fourth quarter earnings results are currently tracking to a 1.7% year-over-year increase. In other words, corporate profits are on pace to exceed pre-pandemic highs even before additional stimulus, wider distribution of vaccines, and a more robust economic re-opening even take hold.

And while the rally in the overall markets alongside more speculative activity in heavily shorted stocks or some cryptocurrencies like Dogecoin (DOGE-USD) might have some investors nervous, this return to earnings growth is textbook early cycle behavior.

In his latest note to clients published Tuesday, Keith Lerner, chief market strategist at Truist Advisory Services, highlighted the following chart showing the present rebound in earnings tracking right alongside what we saw coming out of the financial crisis.

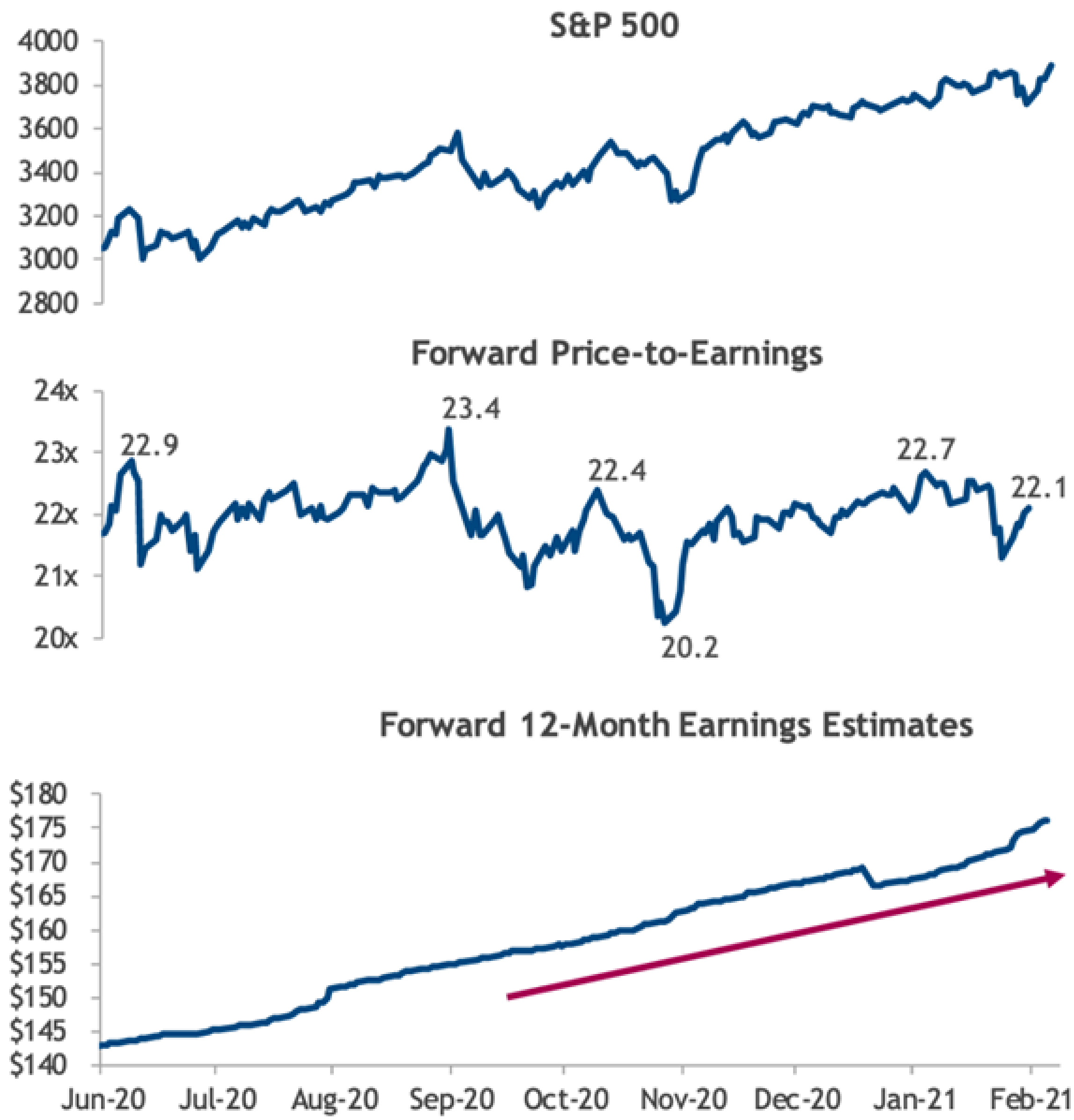
Earnings crashed in 2020 as the pandemic brought the economy to a stop, but the huge rebound in profits expected this year and next make the market look a lot like it did coming out of the financial crisis. (Source: Truist SunTrust Advisory Services)

"Indeed, the earnings power of corporate America remains under-appreciated," Lerner writes.

"This is aligned with the view that we laid out last summer that surviving companies were set to come out on the other side of this crisis more efficient and profitable than ever, aided by the acceleration of technology and productivity trends."

Readers of the Morning Brief will be familiar with this idea from our prior work on operating leverage and how this force can boost corporate bottom lines as we return to economic growth.

We'd also note that holding a constructive view on the market does not mean Lerner or anyone else with this position is blind to elevated valuations, which are almost uniformly high relative to history. Though as Lerner notes, we haven't exactly seen valuations rise over the last six months as earnings expectations have outpaced the market's gains.



A common talking point in markets has been how expensive stocks are relative to history. And while valuations are elevated, a huge rebound in earnings expectations has outpaced gains in the S&P 500, keeping valuations relatively stable for six months now. (Source: Truist SunTrust Advisory Services)

“The market is not cheap on an absolute basis; however, it also does not appear to be in a bubble either,” Lerner adds.

“Our work shows that it is typical for stocks to see positive returns but a notable moderation of gains after the initial snapback from a bear market low. In the current phase of the bull market, we continue to expect the driver of equity gains to be an earnings recovery.”

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